



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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FROM: John J. McGreevy
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CC:PA:APJP

SUBJECT: POSTN-138502-03

This Chief Counsel Advice responds to your memorandum dated June 25, 2003. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

Corporation A:

Corporation B:

Corporation C:

Year 1:

Year 2:

Year 5:

Year 6:

Year 7:

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Year 8:

Year 9:

Year 10:

Year 11:

Year 12:

Year 13:

Year 14:

Year 17:

Year 20:

Year 21:

Year 22:

ISSUES

1. Whether Corporation B may file a valid interest netting claim under I.R.C. § 6621(d) with respect to Corporation A. Corporation A filed a consolidated return as the parent of an affiliated group for overpayment Years 5 and 6 and subsequently filed a consolidated return as a member of a second affiliated group for which Corporation B is the parent for underpayment Years 10 through 14.
2. Whether Corporation B may file a valid interest netting claim under I.R.C. § 6621(d) with respect to Corporation C. Corporation C had an underpayment in Year 1 and subsequently filed a consolidated return with the affiliated group for which Corporation B is the parent for overpayment Years 8 and 9.

CONCLUSIONS

1. Interest netting is possible to the extent Corporation A is both entitled to interest from the Years 5 and 6 overpayments and severally liable for interest owing from the Years 10 through 14 underpayments.

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2. Corporation C will meet the same taxpayer test to the extent it is entitled to a portion of the Years 8 and 9 overpayments. However, interest netting is not possible in this case because I.R.C. § 6621(d) requires that both the period of limitation for both the underpayments and overpayments be open as of July 22, 1998, and the period of limitations for Corporation C's Year 1 underpayment expired well before July 22, 1998.

FACTS

In Year 2, Corporation C filed its Year 1 return. Sometime after Year 2, it was determined that Corporation C had an underpayment for its Year 1 tax year. This underpayment was paid in Year 11.

Prior to Year 7, Corporation A was the parent of an affiliated group. In Year 5 and Year 6, the affiliated group filed consolidated returns and had overpayments for each year. The Service refunded the overpayments in Year 17.

In Year 7, Corporation A transferred many of its assets to Corporation B. Corporation A was not dissolved. Beginning Year 7, Corporation B was the parent of an affiliated group of which Corporation A and Corporation C were subsidiaries. In Year 8 and Year 9, the affiliated group had overpayments, which the Service refunded in Year 17. In Year 10 through Year 14, the affiliated group had underpayments.

Corporation B wants to net interest from the Year 5 and Year 6 overpayments against interest from the Year 10 through Year 14 underpayments. In addition, Corporation B wants to net interest from the Year 8 and Year 9 overpayments against interest from Corporation C's Year 1 underpayment.

LAW AND ANALYSIS

I.R.C. § 6601(a) requires that interest be paid by a taxpayer, if any amount of tax "is not paid on or before the last date prescribed for payment," which is generally the date prescribed by I.R.C. § 6072(b) for filing the return. Any tax that has not been paid on or before the return due date is an underpayment.

In addition, where a taxpayer has made an overpayment with respect to any internal revenue tax, I.R.C. § 6611(a) requires that interest be paid to the taxpayer who made the overpayment. Neither the Code nor the regulations promulgated thereunder define the term "overpayment." The United States Supreme Court defines "overpayment" as "any payment in excess of that which is properly due." Jones v. Liberty Glass Co., 332 U.S. 524, 531 (1947); see also United States v. Dalm, 494 U.S. 596 (1990).

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I.R.C. §§ 6621(a)(1) and (2) establish the interest rates for both overpayments and underpayments of tax. I.R.C. § 6621(d) provides that to the extent interest is payable for any period under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer of tax imposed by the Code, the net rate of interest under I.R.C. § 6621 on such amounts shall be zero for such period.

Each overpayment or underpayment is only considered once in determining whether equivalent overpayments and underpayments exist. However, if the full amount of the overpayment or underpayment has not been used in a netting calculation, the remaining portion may be used in another netting calculation. See Rev. Proc. 2000-26, 2000-1 C.B. 1257; Rev. Proc. 99-43.

I.R.C. § 1501 allows affiliated corporations to file a consolidated return with respect to income tax. A condition for filing a consolidated return is that all members of the affiliated group must consent to be bound by all regulations promulgated under I.R.C. § 1502. Id. The making of a consolidated return is considered to be such consent. Id.

Treas. Reg. § 1.1502-6(a) provides that in general all members of an affiliated group that filed a consolidated return are severally liable for the tax for such year.

Treas. Reg. § 1.1502-77A(a) provides that the use of the affiliated group's overpayment will generally be at the discretion of the parent of the affiliated group. Further, any claim for credit or refund is to be made by the parent, and such refund will be made directly to and in the name of the parent and will discharge any liability of the Government with respect to any subsidiary. Id.

Netting of the Year 5 and Year 6 Overpayment Interest Against the Year 10 through Year 14 Underpayment Interest

As described above, I.R.C. § 6621(d) requires that the same taxpayer both be liable for the underpayment of tax, and entitled to the overpayment of tax. Here, Corporation A, which was the parent of an affiliated group in Years 5 and 6 (the overpayment years), and a member of an affiliated group in Years 10 through 14 (the underpayment years). As all members of an affiliated group that file a consolidated return are severally liable for the tax for such year, Corporation A is severally liable for the affiliated group's Years 10 through 14 underpayments. Therefore, because Corporation A is the same taxpayer with respect to its allocable share of the Year 5 and 6 overpayments and the Years 10 through 14 underpayments, interest netting is possible in this situation.

Corporation B, as parent of the affiliated group, is permitted to file the interest claim pursuant to Treas. Reg. § 1.1502-77A(a). If all of the members of the affiliated group

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for which Corporation A was the parent became members of the affiliated group for which Corporation B is the parent then no allocation of the Year 5 and Year 6 overpayment is required. However, the facts are unclear on this point.

Before interest netting is allowed, however, the Service must take into account any portions of the Year 5 and Year 6 overpayments that have been previously used as part of a netting calculation. Because it is only possible to use an overpayment once in a netting calculation, the amount of the Year 5 and Year 6 overpayments that are available for interest netting will be reduced by the amount previously netted against any underpayments.

Netting of the Year 8 and Year 9 Overpayment Interest Against Corporation C's Year 1 Underpayment Interest

I.R.C. § 6621(d) generally applies to interest for periods beginning after July 22, 1998. See section 3301(c)(1) of the IRS Restructuring and Reform Act of 1998 (RRA). However, § 3301(c)(2) of the RRA provides that I.R.C. § 6621(d) applies to interest for periods beginning before July 22, 1998 (i.e. interest accruing before October 1, 1998), provided certain conditions are met. First, such netting is "subject to any applicable statute of limitation not having expired with regard to either a tax underpayment or a tax overpayment . . ." Second, the taxpayer must reasonably identify and establish periods of tax overpayments and underpayments for which the net interest rate of zero applies. Third, the taxpayer must request the Secretary of the Treasury apply I.R.C. § 6621(d) to such periods no later than December 31, 1999. Id.

With respect to the first requirement, Rev. Proc. 99-43, in applying § 3301(c)(2) of the RRA, states that the period of limitations for both the applicable underpayment and overpayment periods must have been open as of July 22, 1998. Rev. Proc. 99-43, 1999-2 C.B. 579, at section 4.01. The applicable underpayment interest period expires either three years from the time the tax return was filed, or two years from the time the interest was paid, whichever comes later. Id. at section 4.02(1).

Corporation C will be the same taxpayer with respect to its Year 1 underpayment and its share of the Year 8 and Year 9 overpayments. Corporation C filed its Year 1 return in Year 2, and fully paid its Year 1 underpayment in Year 11. The later period of either three years from the time the return was filed or two years from the time the interest was paid, is the two year period from the time the interest was paid in Year 11. Two years from Year 11 is Year 13. Year 13 occurred well before July 22, 1998. Accordingly, the period of limitations for Corporation C's Year 1 underpayment was closed prior to July 22, 1998. Because Corporation C's Year 1 tax year was closed as of July 22, 1998, interest netting is not possible in this case.

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CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

There are some litigation hazards associated with the situation involving Corporation C's Year 1 underpayment. As stated above, for periods before July 22, 1998, § 3301(c)(2) of the RRA provides that netting is "subject to any applicable statute of limitation not having expired with regard to either a tax underpayment or a tax overpayment . . ." Rev. Proc. 99-43 states that the statute requires the applicable periods of limitation for both the underpayments and overpayments be open on July 22, 1998. In Federal National Mortgage Association v. United States, 56 Fed. Cl. 228 (2003), the court refused to follow Rev. Proc. 99-43, and held that only one of the periods of limitation must be open. Our office does not agree with the Court of Claims, and is recommending that Federal National Mortgage Association be appealed. If you have concerns regarding the status of this issue, we recommend you contact our office for further advice.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call if you have any further questions.